United Nations A/CN.9/611

General Assembly

Distr.: Limited
16 May 2006

Original: English

United Nations Commission on International Trade Law
Thirty-ninth session
New York, 19 June-7 July 2006

Security Interests

Draft Legislative Guide on Secured Transactions

Security rights in receivables

Note by the Secretariat*

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* This document is submitted later than the required ten weeks prior to the start of the meeting because of the need to include changes decided at the tenth session of the Working Group held in New York from 1 to 5 May 2006.

V.06-54134 (E) 060606 060606

Security rights in receivables

[*Note to the Commission: In the context of its discussion on security rights in receivables, the Commission may wish to consider the definitions (a) ("security right"), (d) ("secured creditor"), (f) ("grantor"), (p) ("receivable"), (q) ("assignment"), (r) ("assignor"), (s) ("assignee"), (t) ("subsequent assignment"), (u) ("debtor of the receivable"), (v) ("notification of the assignment") and (w) ("original contract") (see A/CN.9/WG.VI/WP.27/Add.1).*]

Parties, security rights, secured obligations and assets covered

3. In particular, the law should provide that it applies to:

(d) All types of movable assets and attachments, tangible or intangible, present or future, not specifically excluded in the law, including inventory, equipment and other goods, contractual and non-contractual receivables, contractual non-monetary obligations, negotiable instruments, negotiable documents, rights to payment of funds credited to bank accounts, proceeds under independent undertakings, and intellectual property rights;

[*Note to the Commission: As to non-contractual receivables, the Commission may wish to refer to the note after definition (p) ("receivable") in A.CN.9/WG.VI/WP.27/Add.1. As to contractual non-monetary obligations, the Commission may wish to note that the commentary will explain that the general recommendations apply to contractual non-monetary obligations. The commentary will also explain that general law other than the law recommended in the draft Guide applies to the rights of obligors of contractual non-monetary obligations.*]

...

(f) Generally, outright transfers of receivables;

[*Note to the Commission: The Commission may wish to note that, as the definition of "receivable" excludes rights to payment under a negotiable instrument, the obligation to pay under an independent undertaking and the obligation of a bank to pay funds credited to a bank account, recommendation 3 (f) does not apply to an outright transfer of a negotiable instrument, proceeds under an independent undertaking or a right to payment of funds credited to a bank account. However, the recommendations apply to transfers of such assets for security purposes, as they are treated as secured transactions. For example, the transfer for security purposes of a right to payment of funds credited to a bank account is covered as a method of achieving control (see definition of "control" in A/CN.9/WG.VI/WP.27/Add.1, para. 21 (ee) and (gg)). The commentary will explain that outright transfers of negotiable instruments, proceeds under an independent undertaking and funds credited to a bank account have been excluded as: (i) they raise different issues and would require special rules, (ii) unlike receivables in which a security transfer and an outright transfer would compete for priority based on the order of registration, with respect to negotiable instruments a secured creditor could always obtain a superior right by taking possession of the instrument, while, in the case of proceeds under an independent undertaking and funds credited to a bank account, a secured creditor could obtain a superior right by control. The commentary will also discuss issues arising in outright transfers of negotiable*

instruments other than cheques for the benefit of States that may wish to address them in the law.]

4. Except to the limited extent provided in recommendations 16 and 37 relating to a personal or property right that secures a receivable, negotiable instrument or other obligation that is within the scope of the Guide, the law should not apply to security rights in [*see A/CN.9/WG.VI/WP.26/Add.7*].

Creation of a security right in receivables

[*Note to the Commission: The Commission may wish to note that the commentary will explain that the general recommendations apply unless modified by asset-specific recommendations.*]

Assets and obligations subject to a security agreement

13. The law should provide that a security right may secure all types of obligation, including future, conditional and fluctuating obligations. It should also provide that a security right may be given in all types of asset, including parts of assets and undivided interests in assets and assets which, at the time of the security agreement, the grantor may not yet own or have the power to dispose of, or which may not yet exist, as well as in proceeds. Any exceptions to these rules should be limited and described clearly in the law.

Effectiveness of a bulk assignment and an assignment of future, parts of and undivided interests in receivables

14. The law should provide that:

(a) The assignment of receivables that are not specifically identified, future receivables and parts of or undivided interests in receivables is effective as between the assignor and the assignee and as against the debtor of the receivable, as long as, at the time of the assignment or, in the case of future receivables, at the time they arise, they can be identified to the assignment to which they relate; and

(b) Unless otherwise agreed, an assignment of one or more future receivables is effective without a new act of transfer being required to assign each receivable. [*See article 8 of the United Nations Assignment Convention.*]

Effectiveness of an assignment made despite an anti-assignment clause

15. The law should provide that:

(a) An assignment is effective as between the assignor and the assignee and as against the debtor of the receivable notwithstanding an agreement between the initial or any subsequent assignor and the debtor of the receivable or any subsequent assignee limiting in any way the assignor's right to assign its receivables;

[*Note to the Commission: The Commission may wish to note that the commentary will explain that recommendation 15 (a) makes ineffective only an agreement between an obligor and an obligee that limits the obligee's right to assign a receivable owed by the obligor to the obligee. If such a receivable is assigned, the obligor is the "debtor of the receivable" and the obligee is the "assignor".*

For example, if an agreement for the lease of goods limits the lessor's right to assign the rents due to it under the lease, recommendation 15 (a) makes the limitation on assignment ineffective, because the agreement is between the obligor (the lessee) and the obligee (the lessor) of the receivable (the rent arising from the lease agreement). By way of contrast, if the lease agreement between the lessor and the lessee limits the lessee's right to assign a receivable consisting of the lessee's claim to rents due to the lessee from the sublessee under a sublease, recommendation 15 (a) has no application, and nothing in this Guide makes the limitation ineffective. That is because the agreement limiting the right of the lessee to assign its claim for rents due to it from the sublessee under the sublease is not an agreement between the lessee (sublessor and obligee in a sublease) and the sublessee (obligor in the sublease). Whether the limitation in the lease is enforceable against the lessee would be determined by the law other than the law recommended in this Guide.

The same analysis would apply if the restriction on transfer was contained in a licence of intellectual property. Recommendation 15 (a) would render ineffective a term in the licence agreement that restricted the licensor from assigning fees due from the licensee. However, it would not render ineffective a term in the licence agreement restricting the licensee from assigning sublicence fees. Whether the latter term would be effective would be determined by law other than that recommended in the draft Guide.]

(b) If other law creates any obligation or liability of the assignor for breach of such an agreement, the other party to such an agreement may not avoid the contract from which the assigned receivables arise or the assignment contract on the sole ground of that breach. A person who is not a party to such an agreement is not liable on the sole ground that it had knowledge of the agreement;

(c) This recommendation applies only to assignments of receivables:

(i) Arising from an original contract that is a contract for the supply or lease of goods or services other than financial services, a construction contract or a contract for the sale or lease of real property;

(ii) Arising from an original contract for the sale, lease or licence of industrial or other intellectual property or of proprietary information;

(iii) Representing the payment obligation for a credit card transaction;

(iv) Owed to the assignor upon net settlement of payments due pursuant to a netting agreement involving more than two parties.

[*Note to the Commission: The Commission may wish to note that the commentary will clarify that contract avoidance referred to in paragraph (b) means contract termination in general.*]

Creation of a security right in a right that secures an assigned receivable, a negotiable instrument or any other obligation

16. The law should provide that:

(a) A security right in a receivable, a negotiable instrument or any other obligation covered as an encumbered asset by this law automatically extends, without further action by either the grantor or the secured creditor, to any personal

or property right that secures payment or performance of the receivable, negotiable instrument or other obligation;

(b) If the personal or property right is an independent undertaking, the security right automatically extends to the proceeds under the independent undertaking but does not extend to the right to draw under the independent undertaking;

(c) This recommendation does not apply to a right in immovable property that under law other than this law is transferable separately from a receivable, negotiable instrument or other obligation that it may secure;

(d) A security right is created under paragraph (a) of this recommendation in any personal or property right securing payment of a receivable, negotiable instrument or other obligation notwithstanding any agreement between the grantor and the debtor of the receivable or the obligor of the negotiable instrument or other obligation limiting in any way the grantor's right to create a security right in the receivable, negotiable instrument or other obligation, or in any personal or property right securing the receivable, negotiable instrument or other obligation;

(e) If other law creates any obligation or liability of the grantor for breach of the agreement mentioned in paragraph (d) of this recommendation, the other party to such an agreement may not avoid the contract from which the receivable, negotiable instrument or other obligation arise, or the security agreement creating the personal or property security right on the sole ground of that breach. A person who is not a party to such an agreement is not liable on the sole ground that it had knowledge of the agreement;

(f) Paragraphs (d) and (e) of this recommendation apply only to security rights in receivables, negotiable instruments or other obligations:

(i) Arising from an original contract that is a contract for the supply or lease of goods or services other than financial services, a construction contract or a contract for the sale or lease of immovable property;

(ii) Arising from an original contract for the sale, lease or licence of industrial or other intellectual property or of proprietary information;

(iii) Representing the payment obligation for a credit card transaction;

(iv) Owed to the assignor upon net settlement of payments due pursuant to a netting agreement involving more than two parties.

(g) The creation of a security right in a possessory property right under paragraph (a) of this recommendation does not affect any obligations of the grantor to the debtor of the receivable or the obligor of the negotiable instrument or other obligation with respect to the relevant property existing under the law governing that property right;

(h) To the extent that the automatic creation under paragraph (a) of this recommendation and the automatic third-party effectiveness under recommendation 37 of a security right in any personal or property security right securing payment of a receivable, negotiable instrument or other obligation is not impaired, this recommendation does not affect any requirement under law other than this law relating to the form or registration of the creation of security rights in any

assets, securing payment of a receivable, negotiable instrument or other obligation, that are outside the scope of this law.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that the purpose of recommendation 16 is to facilitate financing transactions, such as securitizations of pools of loans secured by security rights in movables and immovables. In these cases the buyer of the loans will want to be able to look to the security rights securing the loans but would not want to incur, at the outset of the purchase, the additional expense of a separate act of transfer (if required under law other than the law recommended in the draft Guide) for each loan in the pool of loans, that could number in the hundreds or thousands. Separate acts of transfer, if any, would be necessary (if required under other law) to enforce only those loans that are later in default, typically a small proportion of the loans in the pool actually purchased. The buyer could decide whether to accept the expense of separate acts of transfer at the time of enforcement, whether voluntarily from the seller or with the assistance of a court. But, in deciding whether to purchase the loans and at what price, the buyer would take into account the expense of separate acts of transfer only for the small portion of the loans expected to be in default, not for the entire pool of loans. As a result of the expense savings, the seller should be able to obtain a higher purchase price, thereby making more funds available to the seller.*

The commentary will also make it clear that recommendation 16 applies to outright transfers of receivables (but not of negotiable instruments or other obligations) as the draft Guide generally applies only to outright transfers of receivables.

The commentary will also clarify that paragraphs (a) to (c) track the language of article 10 (1) of the United Nations Assignment Convention with appropriate adjustments necessary in view of the nature of the law in the draft Guide as domestic law, while paragraphs (d) to (f) track the language of recommendation 15 and article 10 (2) to (4) of the United Nations Assignment Convention.

In addition, the commentary will clarify that paragraph (g) tracks the language of article 10 (5) of the United Nations Assignment Convention, according to which, if the security right involves the delivery of possession of an asset and such delivery causes damage to the debtor of the receivable or the obligor of the negotiable instrument or other obligation, any liability that may exist under law applicable outside the law recommended in the draft Guide is not affected. This may arise, for example, in the case of a delivery of possession of an item of valuable tangible property if the secured creditor or transferee damages or loses the property.

Furthermore, the commentary will clarify that paragraph (h), which tracks the language of article 10 (6) of the United Nations Assignment Convention, makes it clear that, the form of transfer of a security right in an asset outside the scope of this law (e.g. an immovable) is left to law other than this law, at least to the extent that the automatic creation and third-party effectiveness of a security right is not impaired. Accordingly, a notarized document and registration may be necessary for the transferee of a mortgage to obtain various rights under immovables law, such as the right to enforce the mortgage. The commentary will further explain that the form

of transfer of a security right in an asset within the scope of this law will be subject to this law.]

Pre-default rights and obligations of the assignor and the assignee

[*Note to the Commission: The Commission may wish to note that the following recommendations, based on articles 11 to 14 of the United Nations Assignment Convention, will be included in the new chapter on pre-default rights and obligations of the parties.*]

Rights and obligations of the assignor and the assignee

16 bis. The law should provide that:

(a) The mutual rights and obligations of the assignor and the assignee arising from their agreement are determined by the terms and conditions set forth in that agreement, including any rules or general conditions referred to therein;

(b) The assignor and the assignee are bound by any usage to which they have agreed and, unless otherwise agreed, by any practices they have established between themselves.

Representations of the assignor

16 ter. The law should provide that:

(a) Unless otherwise agreed between the assignor and the assignee, the assignor represents at the time of conclusion of the contract of assignment that:

(i) The assignor has the right to assign the receivable;

(ii) The assignor has not previously assigned the receivable to another assignee; and

(iii) The debtor of the receivable does not and will not have any defences or rights of set-off;

(b) Unless otherwise agreed between the assignor and the assignee, the assignor does not represent that the debtor of the receivable has, or will have, the ability to pay.

Right to notify the debtor of the receivable

16 quater. The law should provide that:

(a) Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor of the receivable notification of the assignment and a payment instruction, but after notification has been sent only the assignee may send such an instruction; and

(b) Notification of the assignment or a payment instruction sent in breach of any agreement referred to in paragraph (a) of this recommendation is not ineffective for the purposes of recommendation 19 by reason of such breach. However, nothing in this recommendation affects any obligation or liability of the party in breach of such an agreement for any damages arising as a result of the breach.

Right to payment

16 quinquiens. The law should provide that:

(a) As between the assignor and the assignee, unless otherwise agreed and whether or not notification of the assignment has been sent:

(i) If payment in respect of the assigned receivable is made to the assignee, the assignee is entitled to retain the proceeds and goods returned in respect of the assigned receivable;

(ii) If payment in respect of the assigned receivable is made to the assignor, the assignee is entitled to payment of the proceeds and also to goods returned to the assignor in respect of the assigned receivable; and

(iii) If payment in respect of the assigned receivable is made to another person over whom the assignee has priority, the assignee is entitled to payment of the proceeds and also to goods returned to such person in respect of the assigned receivable;

(b) The assignee may not retain more than the value of its right in the receivable.

Rights and obligations of the debtor of the receivable and the assignee

Protection of the debtor of the receivable

[*Note to the Commission: The Commission may wish to note that recommendations 17 to 23, which are based on articles 15-21 of the United Nations Assignment Convention, will be placed in a separate chapter dealing with rights and obligations of third-party obligors, along with the recommendations dealing with the rights and obligations of an obligor under a negotiable instrument, a depositary bank, the issuer of a negotiable document and the guarantor/issuer, confirmer or nominated person under an independent undertaking.*]

17. The law should provide that:

(a) Except as otherwise provided in this law, an assignment does not, without the consent of the debtor of the receivable, affect the rights and obligations of the debtor of the receivable, including the payment terms contained in the original contract;

(b) A payment instruction may change the person, address or account to which the debtor of the receivable is required to make payment, but may not change:

(i) The currency of payment specified in the original contract; or

(ii) The State specified in the original contract in which payment is to be made to a State other than that in which the debtor of the receivable is located.

Notification of the debtor of the receivable

18. The law should provide that:

(a) Notification of the assignment or a payment instruction is effective when received by the debtor of the receivable if it is in a language that is reasonably expected to inform the debtor of the receivable about its contents. It is sufficient if notification of the assignment or a payment instruction is in the language of the original contract; and

(b) Notification of the assignment or a payment instruction may relate to receivables arising after notification and that notification of a subsequent assignment constitutes notification of all prior assignments.

Discharge of the debtor of the receivable by payment

19. The law should provide that:

(a) Until the debtor of the receivable receives notification of the assignment, it is entitled to be discharged by paying in accordance with the original contract;

(b) After the debtor of the receivable receives notification of the assignment, subject to paragraphs (c) to (h) of this recommendation, it is discharged only by paying the assignee or, if otherwise instructed in the notification of the assignment or subsequently by the assignee in a writing received by the debtor of the receivable, in accordance with such payment instruction;

(c) If the debtor of the receivable receives more than one payment instruction relating to a single assignment of the same receivable by the same assignor, it is discharged by paying in accordance with the last payment instruction received from the assignee before payment;

(d) If the debtor of the receivable receives notification of more than one assignment of the same receivable made by the same assignor, it is discharged by paying in accordance with the first notification received;

(e) If the debtor of the receivable receives notification of one or more subsequent assignments, it is discharged by paying in accordance with the notification of the last of such subsequent assignments;

(f) If the debtor of the receivable receives notification of the assignment of a part of or an undivided interest in one or more receivables, it is discharged by paying in accordance with the notification or in accordance with this recommendation as if the debtor of the receivable had not received the notification. If the debtor of the receivable pays in accordance with the notification, it is discharged only to the extent of the part or undivided interest paid;

(g) If the debtor of the receivable receives notification of the assignment from the assignee, it is entitled to request the assignee to provide within a reasonable period of time adequate proof that the assignment from the initial assignor to the initial assignee and any intermediate assignment have been made and, unless the assignee does so, the debtor of the receivable is discharged by paying in accordance with this recommendation as if the notification from the assignee had not been received. Adequate proof of an assignment includes but is not

limited to any writing emanating from the assignor and indicating that the assignment has taken place;

(h) This recommendation does not affect any other ground on which payment by the debtor of the receivable to the person entitled to payment, to a competent judicial or other authority, or to a public deposit fund discharges the debtor of the receivable.

Defences and rights of set-off of the debtor of the receivable

20. The law should provide that:

(a) In a claim by the assignee against the debtor of the receivable for payment of the assigned receivable, the debtor of the receivable may raise against the assignee all defences and rights of set-off arising from the original contract, or any other contract that was part of the same transaction, of which the debtor of the receivable could avail itself as if the assignment had not been made and such claim were made by the assignor;

(b) The debtor of the receivable may raise against the assignee any other right of set-off, provided that it was available to the debtor of the receivable at the time notification of the assignment was received by the debtor of the receivable;

(c) Notwithstanding paragraphs (a) and (b) of this recommendation, defences and rights of set-off that the debtor of the receivable may raise pursuant to recommendations 15 (b) and 16 (d) against the assignor for breach of an agreement limiting in any way the assignor's right to make the assignment are not available to the debtor of the receivable against the assignee.

[*Note to the Commission: The Commission may wish to note that, under recommendation 3 (a) (see A/CN.9/WG.VI/WP.26/Add.7), the draft Guide applies to consumers but does affect the rights of consumers under consumer-protection law.*]

Agreement not to raise defences or rights of set-off

21. The law should provide that:

(a) The debtor of the receivable may agree with the assignor in a writing signed by the debtor of the receivable not to raise against the assignee the defences and rights of set-off that it could raise pursuant to recommendation 20. Such an agreement precludes the debtor of the receivable from raising against the assignee those defences and rights of set-off;

(b) The debtor of the receivable may not waive defences:

(i) Arising from fraudulent acts on the part of the assignee; or

(ii) Based on the debtor of the receivable's incapacity;

(c) Such an agreement may be modified only by an agreement in a writing signed by the debtor of the receivable. The effect of such a modification as against the assignee is determined by recommendation 22, paragraph (b).

[*Note to the Commission: The Commission may wish to note that recommendation 21 is based on article 19 of the United Nations Assignment Convention, which refers to a signed writing only for a waiver of defences or its*

modification. If the Commission decides not to refer to signature in recommendation 8 (see A/CN.9/WG.VI/WP.26/Add.7) but rather to evidence that the grantor intended to grant a security right, it may wish to reconsider the reference to signature in recommendation 21. If reference to signature is retained in recommendation 8, an electronic signature should be sufficient (see note after definition (v) ("notification of the assignment") in A/CN.9/WG.VI/WP.27/Add.1.]

Modification of the original contract

22. The law should provide that:

(a) An agreement concluded before notification of the assignment between the assignor and the debtor of the receivable that affects the assignee's rights is effective as against the assignee, and the assignee acquires corresponding rights;

(b) An agreement concluded after notification of the assignment between the assignor and the debtor of the receivable that affects the assignee's rights is ineffective as against the assignee unless:

(i) The assignee consents to it; or

(ii) The receivable is not fully earned by performance and either the modification is provided for in the original contract or, in the context of the original contract, a reasonable assignee would consent to the modification.

(c) Paragraphs (a) and (b) of this recommendation do not affect any right of the assignor or the assignee arising from breach of an agreement between them.

Recovery of payments

23. The law should provide that failure of the assignor to perform the original contract does not entitle the debtor of the receivable to recover from the assignee a sum paid by the debtor of the receivable to the assignor or the assignee.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that recommendation 23 does not affect any liability of the assignor towards the debtor of the receivable for breach of contract.*]

Third-party effectiveness of a security right in receivables

37. The law should provide that, if a security right in a receivable, negotiable instrument or any other obligation covered as an encumbered asset by this law is effective against third parties, the security right is automatically effective against third parties with respect to any personal or property right that secures payment or performance of the receivable, negotiable instrument or other obligation, without further action by either the grantor or the secured creditor. If the personal or property right is an independent undertaking, a security right in the proceeds under the independent undertaking is automatically effective against third parties (but, as provided in recommendation 16, the security right does not extend to the right to draw under the independent undertaking). This recommendation does not apply to a right in immovable property that under applicable law is transferable separately from a receivable, negotiable instrument or other obligation that it may secure.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that the general third-party effectiveness recommendations*

apply to security rights in receivables, as well as to outright transfers of receivables. The language in parenthesis in the second sentence explains that the security right does not extend to the right to draw. Thus there is no issue of third-party effectiveness in that regard.]

Priority of security rights in receivables

[*Note to the Commission: The Commission may wish to note that the commentary will explain that the general priority recommendations apply to security rights in receivables as well as to outright transfers of receivables.*]

Enforcement of a security right in receivables

Application of this chapter to outright transfers of receivables

88. The law should provide that, with the following exceptions, this chapter does not apply to an outright transfer of receivables:

(a) Recommendation 89 in the case of an outright transfer with recourse; and

(b) Recommendations 102 and 103.

General standard of conduct

89. The law should provide that all parties must exercise their rights and perform their obligations under the recommendations of this chapter in good faith and in a commercially reasonable manner.

Collection of receivables

102. The law should provide that, in the case of an outright transfer of a receivable, the assignee has the right to collect or otherwise enforce the receivable. In the case of a transfer of a receivable by way of security, the assignee is entitled, subject to recommendations 17 to 23, to collect or otherwise enforce the receivable only after default or before default with the agreement of the assignor.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that the secured creditor may, as an alternative to collection, elect to dispose of or retain a receivable pursuant to recommendations 93 (d), (e), 110 and 113 (see A/CN.9/611/Add.2). The commentary will also explain that the assignee may send a notification and a payment instruction even in breach of an agreement with the assignor (see rec. 16 quater above).*]

103. The law should provide that the assignee's right to collect or otherwise enforce a receivable includes the right to collect or otherwise enforce any personal or property right that secures payment of the receivable (such as a guarantee or security right).

[*Note to the Commission: The Commission may wish to note that the commentary will discuss how other recommendations of the chapter on enforcement may apply to the enforcement of a right securing payment of an assigned receivable.*]

Law applicable to security rights in intangible property

137. The law should provide that the creation, the effectiveness against third parties and the priority over the rights of competing claimants of a security right in intangible property are governed by the law of the State in which the grantor is located. [However, with respect to security rights in intangible property that is subject to a title registration system, the law should provide that such issues are governed by the law of the State in which [...].]

137 bis. The law should provide that the law of the State in which the assignor is located governs the creation, third-party effectiveness and priority of a security right in a receivable arising from a sale or lease of, or a security agreement relating to, an immovable over the rights of competing claimants. However, a priority conflict involving the rights of a competing third party registered in the immovables registry of the State in which the immovable is located is governed by the law of that State.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that recommendation 137 bis is designed to address the law applicable to assignments of receivables owing to the grantor under an agreement for the sale or lease of an immovable or under a security agreement over an immovable. In a number of States, it is not possible to create rights in such receivables independently of the related immovable with the result that the effectiveness as between the parties, the third-party effectiveness and the priority of a security right in the receivables is governed by the law (and, in particular, the registry regime) that applies to the related immovable. In other States, it is possible to grant a security right in such receivables independently of the related immovable but the secured creditor is subordinated to third-party rights that are registered against the related immovable in the immovables registry. The second sentence of recommendation 137 bis is designed to preserve the application of the law of the State where the related immovable is located in order to protect third parties who rely on the registration in the immovables registry of that State. Reference is made to rights of a competing third party as the term "competing claimant" is defined by reference to security rights in movables. Reference is also made to "rights" of such parties, since rights of third parties could include not just competing mortgagees but also assignees or buyers of the immovable or the related intangible and indeed any class of third party right for which the immovables regime makes provision for registration. In addition, reference is made to a right "registered in the immovables registry" rather than "that became effective against third parties by registration", since: (i) some immovables registries do not distinguish between inter-parties and third party effectiveness, and (ii) immovables registries do not necessarily require registration for general third-party effectiveness but only for effectiveness against third parties whose rights are also registrable in the immovables registry (e.g. registration may not be needed for effectiveness against an insolvency administrator or a judgement creditor.*]

Law applicable to the rights and obligations of the grantor and the secured creditor

146. The law should provide that the mutual rights and obligations of the grantor and the secured creditor with respect to the security right, whether arising from the security agreement or by law, are governed by the law chosen by them and, in the absence of a choice of law, by the law governing the security agreement.

Law applicable to the rights and obligations of the debtor of the receivable and the assignee, the obligor under a negotiable instrument or the issuer of a negotiable document and the secured creditor

147. The law should provide that the following matters are governed by the law of the State whose law governs an assigned receivable, or a negotiable instrument or a negotiable document in which a security right has been created:

(a) The relationship between an debtor of the receivable and an assignee of the receivable, between an obligor under a negotiable instrument and a creditor with a security right in that instrument or between an issuer of a negotiable document and a creditor with a security right in that document;

(b) The conditions under which the assignment of the receivable, the transfer of the negotiable instrument or the transfer of the negotiable document can be invoked against the debtor of the receivable, the obligor on the negotiable instrument or the issuer of the negotiable document; and

(c) The determination of whether the obligations of the debtor of the receivable, the obligor on the negotiable instrument or the issuer of the negotiable document have been discharged.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that: (i) recommendation 148 applies to the enforcement of a security right in a receivable (A/CN.9/WG.VI/WP.24), and (ii) the recommendations on the impact of insolvency on the law applicable, as well as the other general recommendations in the conflict-of-laws chapter (A/CN.9/WG.VI/WP.24), apply to security rights in receivables.*]

United Nations A/CN.9/611/Add.1

General Assembly

Distr.: General
17 May 2006

Original: English

United Nations Commission on International Trade Law
Thirty-ninth session
New York, 19 June-7 July 2006

Security Interests

Draft Legislative Guide on Secured Transactions

Security rights in rights to payment of funds credited to a bank account, proceeds under an independent undertaking, negotiable instruments and negotiable documents

Note by the Secretariat*

Addendum

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* This document is submitted later than the required ten weeks prior to the start of the meeting because of the need to include changes decided at the tenth session of the Working Group held in New York from 1 to 5 May 2006. The numbering of the recommendations is not consecutive, as this document contains asset-specific recommendations taken from several chapters of the draft Guide.

V.06-54181 (E) 060606 060606

I. Security rights in rights to payment of funds credited to a bank account

[*Note to the Commission: In the context of its discussion of security rights in rights to payment of funds credited to a bank account, the Commission may wish to consider definitions (ff) ("bank account") and (gg) ("control") (see A/CN.9/WG.VI/WP.27/Add.1). The Commission may also wish to note that the commentary will explain that the term "bank account" does not include accounts held by central banks or payment, clearing and settlement institutions. The commentary will also explain that the secured creditor has control by becoming the account holder where: (i) an existing account is transferred to the secured creditor, (ii) the secured creditor agrees with the grantor that funds should be deposited to an account to be opened later, and (iii) the secured creditor is the only account holder (i.e. not merely a joint account holder).*]

Creation of a security right in a right to payment of funds credited to a bank account

[*Note to the Commission: The Commission may wish to note that the commentary will explain that, pursuant to recommendation 8 (see A/CN.9/WG.VI/WP.26/Add.7), a security right in a right to payment of funds credited to a bank account may be created by agreement between the grantor and the secured creditor.*]

26. The law should provide that a security right in a right to payment of funds credited to a bank account is effective notwithstanding an agreement between the grantor and the depositary bank limiting in any way the grantor's right to create a security right in its right to payment of funds credited to the bank account. However, the depositary bank has no duty to recognize the secured creditor and no obligation is otherwise imposed on the depositary bank with respect to the security right, without the depositary bank's consent.

[*Note to the Commission: The Commission may wish to note that the commentary to recommendation 3 (a) (see A/CN.9/WG.VI/WP.26/Add.7) will clarify that enacting States may wish to take into account any impact that the recommendations in this Guide might have on consumer-protection law.*]

Rights and obligations of the depositary bank

V. The law should provide that:

(a) The creation of a security right in a right to payment of funds credited to a bank account does not affect the rights and obligations of the depositary bank without its consent; and

(b) The rights of set-off of the depositary bank are not impaired by reason of any security right that the depositary bank may have in a right to payment of funds credited to a bank account.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that recommendations V and W are supplemented by recommendations 76, 77 (to the extent that there is a priority conflict between a security right or right of set-off of the depositary bank and a security right of*

another person) and 106 bis, 107 and 108 (enforcement against the depositary bank).

The commentary will also explain that recommendation V (b) does not deal with a priority conflict but with the situation where the depositary bank itself has both a right of set-off against and a security right in a right to payment of funds credited to a bank account. In this situation, according to recommendation V (b), the bank's rights of set-off are not impaired or subsumed into (i.e. they remain distinct from) the bank's security right.]

W. The law should provide that nothing in these recommendations obligates a depositary bank to:

(a) Pay any person other than a person that has control with respect to funds credited to a bank account; or

(b) Respond to requests for information about whether a control agreement or a security right in its own favour exists and whether the grantor retains the right to dispose of the funds credited in the account.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that recommendation W does not affect the bank-customer relationship and the rights and obligations arising from other law governing bank accounts (e.g. money-laundering and bank secrecy).*]

Third-party effectiveness of a security right in a right to payment of funds credited to a bank account

43. The law should provide that a security right in a right to payment of funds credited to a bank account is effective against third parties also if the secured creditor obtains control with respect to the right to payment of the funds credited to the bank account.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that, pursuant to recommendation 35 (see A/CN.9/WG.VI/WP.26/Add.5), a security right in a right to payment of funds credited to a bank account may also become effective against third parties by registration of a notice in the general security rights registry.*]

Priority of a security right in a right to payment of funds credited to a bank account

76. The law should provide that a security right in a right to payment of funds credited to a bank account, which has been made effective against third parties by control, has priority over a security right in a right to payment of the funds, which has been made effective against third parties by any other method. If a depositary bank has concluded more than one control agreement, among those secured creditors, priority is determined according to the order in which the control agreements were concluded. If the secured creditor is the depositary bank, the depositary bank's security right has priority over any other security right (including a security right made effective against third parties by a control agreement with the depositary bank even if the depositary bank's security right is later in time) other than a security right of a secured creditor who has acquired control with respect to

the right to payment of the funds credited to the bank account by becoming the account holder.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that a security right of the depositary bank always has priority even over a security right with respect to which the depositary bank has earlier entered into a control agreement because: (i) a security right of the depositary bank should have the same priority as its set-off right, which has always priority; (ii) if the depositary bank's security right had no priority, the bank would not enter into any control agreement; (iii) a secured creditor could always seek to obtain a subordination agreement from the depositary bank. The commentary will also explain that, depending on the terms of the control agreement, the depositary bank may have a contractual obligation to a secured creditor with a control agreement even though the secured creditor might not have priority.*

In addition, the Commission may wish to note that, at its tenth session, the Working Group agreed that tracing of funds credited to a bank account will be discussed together with the issue of tracing of proceeds (see A/CN.9/603, para. 67). The Commission may wish to deal with that issue as an issue of priority. The commentary to recommendation 76 will make clear that, if a secured creditor has control of a right to payment of funds credited to a bank account, its security right has priority over a security right in cash proceeds of an encumbered asset of another secured creditor that are credited to the same bank account, even if the other secured creditor is able to trace proceeds to the bank account. This is the case even if the competing security right became effective against third parties earlier than the security right held by the secured creditor with control.]

77. The law should provide that any right of the depositary bank to set-off against the right to payment of funds credited to a bank account obligations owed to the depositary bank by the grantor has priority over the security right of any secured creditor other than a secured creditor that has acquired control with respect to the funds credited to the bank account by becoming the account holder.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that these priority recommendations mean that third parties are taken to know that they cannot rely on a right to payment of funds credited to a bank account as a primary source of security for extensions of credit and can do so only by obtaining a subordination agreement from the depositary bank or having the account entered in their own name. Consequently, the absence of publicity of the security right is not seen as problematic. The commentary will also explain that, unlike recommendation V (b), recommendation 77 deals with priority conflicts between rights of set-off of the depositary bank and security rights of other persons. In addition, the commentary will explain that recommendation 77 does not create any rights of set-off, a matter which remains subject to other law. Moreover, the commentary will explain that the exception in recommendation 77 refers to a secured creditor that acquired control by becoming the sole account holder. Where the secured creditor would be just a joint account holder, the grantor will still be able to dispose of the funds credited to the account and thus the secured creditor would not have control (see definition of "control" in A/CN.9/WG.VI/WP.27/Add.1).*]

78. In the case of a transfer of funds from a bank account initiated by the grantor, the law should provide that the transferee of the funds takes free of a security right in the right to payment of funds credited to the bank account, unless the transferee had knowledge that the transfer violated the terms of the security agreement. This recommendation does not lessen the rights of transferees of funds from bank accounts under law other than this law.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that the general priority recommendations apply to security rights in rights to payment of funds credited to a bank account subject to recommendations 76 to 78. The Commission may wish to note that recommendation 79 (see A/CN.9/WG.VI/WP.26/Add.6) may have to be aligned with recommendation 78 to refer to knowledge rather than collusion.*]

Enforcement of a security right in a right to payment of funds credited to a bank account

106 bis. The law should provide that after default, or before default with the agreement of the grantor, a secured creditor with a security right in a right to payment of funds credited to a bank account is entitled, subject to recommendations V and W, to collect or otherwise enforce its right to payment of the funds.

107. The law should provide that after default, or before default with the agreement of the grantor, a secured creditor that has control with respect to a right to payment of funds credited to a bank account is entitled, subject to recommendations V and W, to enforce its security right without having to apply to a court or other authority.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that, unlike a secured creditor that has to collect the funds to apply them to the secured obligation according to recommendation 116 (see A/CN.9/611), a depositary bank as a secured creditor may apply the funds to the secured obligation directly. The commentary will also explain that enforcement of the bank's rights of set-off remains subject to other law.*]

108. The law should provide that a secured creditor that does not have control with respect to funds credited to a bank account is entitled, subject to recommendations V and W, to collect or otherwise enforce the security right against the depositary bank only pursuant to a court order, unless the depositary bank agrees otherwise.

Law applicable to a security right in a right to payment of funds credited to a bank account

139. Except as otherwise provided in recommendation 140, the law should provide that the creation, the effectiveness against third parties, the priority over the rights of competing claimants, the rights and duties of the depositary bank with respect to the security right and the enforcement of the security right in a right to payment of funds credited to a bank account are governed by

Alternative A

the law of the State expressly stated in the account agreement as the State whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law. However, the law of the State determined pursuant to the preceding sentence applies only if the depositary bank has, at the time of the conclusion of the account agreement, an office in that State which is engaged in the regular activity of maintaining bank accounts. The law should also specify that, if the applicable law is not determined pursuant to the preceding two sentences, the applicable law is to be determined pursuant to fallback rules based on article 5 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary.

[*Note to the Commission: Alternative A is an abbreviated version of the approach followed in articles 4.1 and 5 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held With An Intermediary ("the Hague Securities Convention"). The commentary will include the detailed fallback rules in article 5 of the Hague Securities Convention with sufficient explanation.*]

Alternative B

the law of the State in which the bank that maintains the bank account has its place of business. In the case of more than one place of business, reference should be made to the place where the branch maintaining the account is located.

[*Note to the Commission: The Commission may wish to consider, as an alternative or supplementary provision, the law governing the control agreement (see A/CN.9/603, para. 77). The Commission may also wish to note that the commentary will explain that the recommendations on the impact of insolvency on the law applicable, as well as the other general recommendations in the conflict-of-laws chapter (A/CN.9/WG.VI/WP.24), apply to security rights in rights to payment of funds credited to a bank account.*]

II. Security rights in proceeds under an independent undertaking

[*Note to the Commission: In the context of its discussion of security rights in proceeds under an independent undertaking, the Commission may wish to consider definitions (z) ("independent undertaking"), (aa) ("proceeds under an independent undertaking"), (bb) ("guarantor/issuer"), (cc) ("confirmer"), (dd) ("nominated person") and (ee) ("control") (see A/CN.9/WG.VI/WP.27/Add.1).*]

Creation of a security right in proceeds under an independent undertaking

25. The law should provide that a beneficiary may grant a security right in proceeds under an independent undertaking, even if the right to draw under the independent undertaking is not itself transferable under law and practice governing independent undertakings. The grant of a security right in proceeds under an

independent undertaking is not a transfer of the right to draw under an independent undertaking.

[*Note to the Commission: The Commission may wish to note that the commentary will make clear that the second part of the first sentence makes clear the important point that transferability of an independent undertaking itself (i.e. the right to draw) is irrelevant to the right to create a security right in the proceeds under the independent undertaking. The commentary will also explain that the second sentence distinguishes a right to request payment under an independent undertaking from a right to receive the proceeds under an independent undertaking.*]

Rights and obligations of the guarantor/issuer, confirmer or nominated person of an independent undertaking

25 bis. The law should provide that:

(a) A secured creditor's rights in proceeds under an independent undertaking are subject to the rights, under the law and practice that govern independent undertakings, of the guarantor/issuer, confirmer or nominated person and of any other beneficiary named in the undertaking or to whom a transfer of drawing rights has been effected;

(b) The rights of a transferee-beneficiary of an independent undertaking are superior to a security right in proceeds under the independent undertaking acquired from the transferor [or any prior transferor]; and

(c) The independent rights of a guarantor/issuer, confirmer, nominated person or transferee-beneficiary under an independent undertaking are not impaired by reason of any security rights it may have in proceeds under the independent undertaking, including any right in proceeds under the independent undertaking that may result from a transfer of drawing rights to a transferee-beneficiary.

[*Note to the Commission: The Commission may wish to note that the commentary will make clear that this recommendation is intended to ensure that the rights of holders of independent rights to payment, notably nominated persons that have given value and transferee-beneficiaries to whom a transfer has been effected, are superior to mere assignees of rights to proceeds under a drawing by the original beneficiary. The commentary will also explain that their independent rights are distinct and are not impaired because of their rights as secured creditors of the original beneficiary (in other terms, their status as protected holders of independent rights should not be confused with their status as secured creditors). When a nominated person gives value and obtains reimbursement from the guarantor/issuer, it does so on the basis of its independent reimbursement rights and not as an acquirer of the rights of the beneficiary.*]

25 ter. Neither a guarantor/issuer nor a confirmer nor a nominated person is obligated to pay any person other than a named beneficiary, an acknowledged transferee-beneficiary or an acknowledged assignee of proceeds under an independent undertaking.

25 quater. The law should provide that, if a secured creditor has obtained control with respect to proceeds under an independent undertaking by becoming an acknowledged assignee of the proceeds, the secured creditor has the right to enforce

the acknowledgement against the guarantor/issuer, confirmer or nominated person that made the acknowledgement

Third-party effectiveness of a security right in proceeds under an independent undertaking

49. The law should provide that a security right in proceeds under an independent undertaking is made effective against third parties by control with respect to the proceeds under the independent undertaking.

[*Note to the Commission: The Commission may wish to note that recommendation 49 has been revised on the basis of the assumption that neither possession of an independent undertaking nor registration of a notice should be a method of achieving third-party effectiveness of a security right in a right to proceeds under an independent undertaking. Possession of an independent undertaking (even when it is in tangible form) plays only a limited role in the modern use of independent undertakings. In addition, if possession were included in this Guide as a method of achieving effectiveness against third parties, there would be a need for complex rules dealing with priority and conflict of laws. It should be noted, however, that, although possession does not constitute a method of achieving effectiveness against third parties, as a practical matter, possession would give protection to a secured creditor when the terms of the independent undertaking require the physical presentation of the independent undertaking to make a draw under the independent undertaking. In such a circumstance, the beneficiary could not make an effective draw without the secured creditor's cooperation, so the secured creditor could take steps to assure itself of payment (e.g. the secured creditor could require the beneficiary to obtain an acknowledgement that would achieve control for the secured creditor before surrendering the independent undertaking and allowing it to be presented to the guarantor/issuer or nominated person that gave the acknowledgement).*]

Priority of a security right in proceeds under an independent undertaking

62. The law should provide that a security right in proceeds under an independent undertaking, which has been made effective against third parties by control has, with respect to a particular guarantor/issuer, confirmer or nominated person agreeing to give value under an independent undertaking, priority over the rights of all other secured creditors who have not, with respect to that person, made their security right effective against third parties by control. If control has been achieved by acknowledgement and inconsistent acknowledgements have been given to more than one secured creditor by a person, among those secured creditors, priority is determined according to the order in which the acknowledgements were given.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that, as the typical method of achieving control is by obtaining an acknowledgment, in the case of several potential payors (e.g. the guarantor/issuer, confirmer and several nominated persons), control is achieved only vis-à-vis the particular guarantor/issuer(s), confirmer(s) or nominated person(s) who gave the acknowledgment(s). Thus, the priority rule must focus on the particular person who is the payor. The basic priority rule makes clear that a secured creditor that has control of the right to proceeds under an independent undertaking has priority over a secured creditor whose security right became*

effective against third parties automatically. The commentary will also explain that the guarantor/issuer may have a contractual obligation to an acknowledged secured creditor even though the secured creditor might not have priority.]

Enforcement of a security right in proceeds under an independent undertaking

106. The law should provide that effectiveness against third parties of a security right in proceeds under an independent undertaking (whether achieved by control or automatically) is not a prerequisite to enforcing the security right. However, as against the guarantor/issuer, confirmer, nominated person or beneficiary other than the grantor, the security right must be exercised in accordance with recommendations 25 bis, 25 ter and 25 quater.

[*Note to the Commission: The Commission may wish to note that the commentary will make clear that no separate act of transfer by the grantor is necessary for the secured creditor to enforce a security right in a right to proceeds under an independent undertaking when the security right is created automatically under recommendation 16. The commentary will also explain that any obligations of the guarantor/issuer or nominated person to the secured creditor are governed by recommendations 25 bis, 25 ter and 25 quater. Furthermore, the commentary will explain that recommendation 106 is not intended to disturb any pre-default arrangements agreed upon between the grantor and the secured creditor by which, prior to the grantor's default, the secured creditor may receive the proceeds under an independent undertaking.*]

Law applicable to security rights in proceeds under an independent undertaking

138. The law should provide that: (i) the rights and duties of a guarantor/issuer, confirmer or nominated person that has received a request for an acknowledgement or that has or may pay or otherwise give value under an independent undertaking; (ii) the right to enforce a security right in proceeds under an independent undertaking against a guarantor/issuer, confirmer or nominated person; and (iii) except to the extent otherwise provided in recommendation 138 bis, the effectiveness against third parties and the priority over the rights of competing claimants of a security right in proceeds under the independent undertaking are governed, separately with respect to a particular guarantor/issuer, confirmer or nominated person, by the law of the State determined as follows:

(a) If the guarantor/issuer has issued an independent undertaking, the confirmer has issued a confirmation or the nominated person has issued an acknowledgement that specifies that it is governed by the law of a State, the applicable law is the law of the specified State;

(b) If the applicable law is not determined under the preceding paragraph, the applicable law is the law of the State of the location of the branch or office of the guarantor/issuer, confirmer or nominated person indicated in the independent undertaking of the guarantor/issuer, confirmer or nominated person. However, in the case of a nominated person that has not issued an independent undertaking, the applicable law is the law of the State of the location of the nominated person's branch or office that has or may pay or otherwise give value under the independent undertaking.

138 bis. The law should provide that, if a security right in proceeds under an independent undertaking is created and is made effective against third parties automatically as a result of the effectiveness against third parties of a security right in a receivable, negotiable instrument or other obligation which the independent undertaking secures, the creation and the effectiveness against third parties of the security right in the proceeds under the independent undertaking is governed by the law of the State whose law governs the creation and the effectiveness against third parties of the security right in the secured receivable, negotiable instrument or other obligation.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that recommendation 138 follows the conflict-of-laws rules applicable with respect to the rights and obligations of guarantor/issuers, confirmers or nominated persons. The only exception to the principle embodied in recommendation 138 is recommendation 138 bis for the limited issues of creation and third-party effectiveness in the cases where a security right arises or is made effective against third parties automatically.*

In addition, the commentary will explain that each bank (or sometimes non-bank) filling one of these roles acts pursuant to the law where it is located, meaning where its relevant branch or office is located (or the law it chooses, which is typically the law of the State where its relevant branch or office is located). Accordingly, different laws govern the different banks involved, and a choice of law in an independent undertaking governs only the particular issuer's obligations (see URDG article 27, UCC 5-116 (b), and United Nations Assignment Convention article 29). The commentary will also explain that what recommendation 138 strives to do is be clear that a request for acknowledgement or for payment (without prior acknowledgement) made by a secured creditor (or the beneficiary on its behalf) is to be handled by the affected bank branch under its local law.

Under recommendation 138, all priority conflicts are subject to the law chosen by a guarantor/issuer, confirmer or nominated person or, in the absence of a choice of law, to the law of the relevant branch or office. The Commission may wish to consider the question whether: (i) if that bank branch pays (or gives value to) that secured creditor, then that same law should apply to that secured creditor's priority contest with third parties; and (ii), if the payment is to the beneficiary and the priority contest is among third parties, recommendation 138 should be inapplicable and residual conflict-of-laws rules apply (i.e. recommendation 137).

The commentary will further explain that: (i) creation of the security right is governed by the general conflict-of-laws rule in recommendation 137 for security rights in intangibles (except as provided in recommendation 138 bis for automatic creation); and (ii) enforcement of the security right is governed by the general conflict-of-laws rule in recommendation 148, except to the extent otherwise provided in recommendation 138.]

III. Security rights in negotiable instruments

[*Note to the Commission: In the context of its discussion of security rights in negotiable instruments, the Commission may wish to consider definitions (i) ("tangibles") and (x) ("negotiable instrument") (see A/CN.9/WG.VI/WP.27/Add.1).*]

Parties, security rights, secured obligations and assets covered

3. In particular, the law should provide that it applies to:

...

(f) Generally, outright transfers of receivables;

[*Note to the Commission: The Commission may wish to note that, at its tenth session, the Working Group agreed that, while outright transfers of negotiable instruments should not be covered in the draft Guide, a discussion of the relevant issues might be included in the commentary for the benefit of States that might wish to address outright transfers of negotiable instruments because of their importance to financing practices (see A/CN.9/603, para. 50).*

In that connection, the Commission may wish to note that the commentary will explain that, while principles of secured transactions law can easily be made to apply to the outright transfer of promissory notes and, perhaps, bills of exchange other than cheques, in a manner similar to this Guide's coverage of the outright transfer of receivables, those principles do not apply well to the outright transfer of cheques. The latter topic is sufficiently covered by the law of negotiable instruments and the law of bank collections.

The commentary will also explain that an enacting State that wishes to expand the scope of its secured transactions law to apply to outright transfers of negotiable instruments that are either promissory notes or bills of exchange (and to expand its definition of "security right" to cover the right of the transferee in such a transaction) might wish to consider providing that a security right that is an outright transfer of such a negotiable instrument is automatically effective against third parties upon the transfer. Such a rule would avoid disrupting existing financial practices.

In addition, the commentary will explain that, with respect to the priority of such a security right, the general principles of priority would apply. Most particularly, the general principle in recommendation 63 (see A/CN.9/WG.VI/WP.26/Add.6), as qualified by recommendation 74, would govern. As in the case of an outright transfer of a receivable, the outright transferee of such a negotiable instrument should be able to enforce the instrument without further consent of the assignor subject, of course, to the rights of the obligors on the negotiable instrument as described in the chapter on enforcement.]

Creation of a security right in a negotiable instrument

[*Note to the Commission: The Commission may wish to note that the commentary will explain that, pursuant to recommendation 8 (see A/CN.9/WG.VI/WP.26/Add.7), a security right in a negotiable instrument may be*

created by a written and possibly signed agreement between the grantor and the secured creditor or by even an oral agreement and delivery of possession of the instrument to the secured creditor. The commentary will also explain that creation of a security right under this recommendation will not affect rights obtained by endorsement of the negotiable instrument under the law governing negotiable instruments.]

Rights and obligations of the obligor under a negotiable instrument

X. The law should provide that, as between the secured creditor and (i) the person obligated on the negotiable instrument or (ii) other persons claiming rights under the law governing negotiable instruments, the obligations and rights of those persons are determined by the law governing negotiable instruments.

Third-party effectiveness of a security right in a negotiable instrument

[*Note to the Commission: The Commission may wish to note that the commentary will explain that, according to the general third-party effectiveness recommendation 35 (see A/CN.9/WG.VI/WP.26/Add.5), a security right in a negotiable instrument may be made effective against third parties by registration of a notice in the general security rights registry. Recommendation X addresses a special issue.*]

Y. The law should provide that a security right in a negotiable instrument that was made effective against third parties by dispossession continues to be effective against third parties for a short period of [to be specified] days after the negotiable instrument has been relinquished to the grantor for the purpose of presentation, collection, enforcement or renewal.

[*Note to the Commission: The Commission may wish to note that a secured creditor may have to return an encumbered negotiable instrument to the grantor for presentation, collection, enforcement or renewal, if the secured creditor does not have that right. The commentary will also explain that, by returning the encumbered negotiable instrument to the grantor, the secured creditor would be exposed to the risk of losing its security only for a short period of time and only if it had not registered a notice about its security right in the general security rights registry.*]

Priority of a security right in a negotiable instrument

[*Note to the Commission: The Commission may wish to note that the commentary will explain that the general priority recommendations (see A/CN.9/WG.VI/WP.26/Add.6) apply to priority with respect to security rights in negotiable instruments, while recommendations 74 and 74 bis deals with additional priority conflicts.*]

74. The law should provide that a security right in a negotiable instrument that was made effective against third parties by dispossession of the grantor with respect to the instrument has priority over a security right in a negotiable instrument that was made effective against third parties by any other method.

74 bis. The law should provide that a security right in a negotiable instrument that was made effective against third parties by a method other than by dispossession of

the grantor with respect to the instrument is subordinate to the rights of another secured creditor, buyer or other transferee (in a consensual transaction) that either:

(a) Qualifies as a protected holder under the law governing negotiable instruments; or

(b) Takes possession of the negotiable instrument and gives value in good faith and without knowledge that the transfer was in violation of the rights of the holder of the security right.

Enforcement of a security right in a negotiable instrument

104. The law should provide that after default, or before default with the agreement of the grantor, the secured creditor, is entitled, subject to recommendation X, to collect or otherwise enforce a negotiable instrument that is an encumbered asset against a person obligated on that instrument.

[*Note to the Commission: The Commission may wish to note that commentary will explain that as between the secured creditor and (i) the person obligated on the negotiable instrument, or (ii) other persons claiming rights under the law governing negotiable instruments, the enforcement rights of the secured creditor are subject to the law governing negotiable instruments. The commentary will also include the following examples of such persons:*

(a) The person obligated on the negotiable instrument may be obligated to pay only a holder or other person entitled to enforce the instrument under the law governing negotiable instruments; and

(b) The right of the person obligated on the instrument to raise defences to that obligation is determined by the law governing negotiable instruments.]

105. The law should provide that the secured creditor's right to collect or otherwise enforce a negotiable instrument includes the right to collect or otherwise enforce any personal or property right that secures payment of the negotiable instrument (such as a guarantee or security right).

Law applicable to security rights in tangibles

136. The law should provide that, except as otherwise provided in recommendations 140 and 142, the creation, the effectiveness against third parties and the priority over the rights of competing claimants of a security right in tangible property are governed by the law of the State in which the encumbered asset is located. However, with respect to security rights in tangible property of a type ordinarily used in more than one State, the law should provide that such issues are governed by the law of the State in which the grantor is located. [With respect to security rights in the type of tangible property mentioned in the preceding sentence that is subject to a title registration system, the law should provide that such issues are governed by the law of the State under the authority of which the registry is maintained.]

[*Note to the Commission: The Commission may wish to note that the commentary will explain that "tangible property of a type ordinarily used in more than one State" refers to mobile goods, such as motor vehicles. The same term in*

the bracketed sentence in recommendation 136 refers to mobile goods, such as ships and aircraft.]

Law applicable to third-party effectiveness of security rights in specified types of asset by registration

140. If the State in which the grantor is located recognizes registration as a method of achieving effectiveness against third parties of a security right in a negotiable instrument and rights to payment of funds credited to a bank account, the law of that State determines whether the effectiveness against third parties of a security right in such encumbered assets has been achieved by registration under the laws of that State.

Law applicable to the rights and obligations of the grantor and the secured creditor

146. [*See A/CN.9/611.*]

Law applicable to the rights and obligations of the debtor of the receivable and the assignee, the obligor under a negotiable instrument or the issuer of a negotiable document and the secured creditor

147. [*See A/CN.9/611.*]

[*Note to the Commission: The Commission may wish to note that the commentary will explain that: (i) recommendation 148 applies to the enforcement of a security right in a negotiable instrument (A/CN.9/WG.VI/WP.24); and (ii) the recommendations on the impact of insolvency on the law applicable, as well as the other general recommendations in the conflict-of-laws chapter (A/CN.9/WG.VI/WP.24), apply to security rights in negotiable instruments.*]

IV. Security rights in negotiable documents

[*Note to the Commission: In the context of its discussion of security rights in negotiable documents, the Commission may wish to consider definitions (y) ("negotiable document"), (nn) ("possession") and (oo) ("issuer") (see A/CN.9/WG.VI/WP.27/Add.1).*]

Creation of a security right in a negotiable document

[*Note to the Commission: The Commission may wish to note that, the commentary will explain that, pursuant to recommendation 8 (see A/CN.9/WG.VI/WP.26/Add.7), a security right in a negotiable document may be created by a written and possibly signed agreement between the grantor and the secured creditor or even by an oral agreement and delivery of possession of the document to the secured creditor. For the benefit of enacting States that may wish to consider addressing multi-modal transport documents, the commentary will explain that, as the definition of a negotiable document in the draft Guide is left to the law governing negotiable documents, the negotiability of multi-modal transport documents is also left to that law.*]

28. The law should provide that the creation of a security right in a negotiable document also gives rise to a security right in the goods represented by the document, provided that the issuer is in possession of the goods, directly or indirectly, at the time the security right in the document is created.

[*Note to the Commission: The Commission may wish to note that the commentary will clarify that a security right in goods covered by a negotiable document may be created pursuant to recommendation 8 directly in the goods or pursuant to recommendation 28 through the creation of a security right in the negotiable document covering the goods. The commentary will also clarify that recommendation 28 is intended to negate that, in situations where a security right exists in a negotiable document, a separate security right needs to be created in the goods covered by the document. Moreover, the commentary will explain that neither recommendation 8 nor recommendation 28 nor any other recommendation affects rights in negotiable documents acquired under the law governing negotiable documents.*]

Rights and obligations of the issuer of a negotiable document

Z. The law should provide that as between the secured creditor and the issuer or other person obligated on the negotiable document, the rights and obligations of those persons are determined by the law governing negotiable documents.

[*Note to the Commission: The Commission may wish to note that this recommendation will be placed in a separate chapter dealing with the rights and obligations of third-party obligors.*]

Third-party effectiveness of a security right in a negotiable document

44. The law should provide that a security right in a negotiable document is made effective against third parties by delivery of possession of the document to the secured creditor.

44 bis. The law should provide that, if a security right in a negotiable document is effective against third parties, the corresponding security right in the goods covered by the document is also effective against third parties. As long as a negotiable document covers goods, a security right in the goods may be made effective against third parties by dispossession of the grantor with respect to the document.

44 ter. The law should provide that a security right in a negotiable document that was made effective against third parties by dispossession of the grantor remains effective against third parties for a short period of [to be specified] days after the negotiable document has been relinquished to the grantor or other person for the purpose of ultimate sale or exchange, loading or unloading, or otherwise dealing with the goods covered by the negotiable document.

Priority of a security right in a negotiable document

[*Note to the Commission: The Commission may wish to note that the commentary will clarify that the general priority recommendations apply to security rights in negotiable documents, while recommendations 80 and 81 deal with additional priority conflicts.*]

80. The law should provide that, while goods are in the possession of the issuer of a negotiable document with respect to them, a security right in those goods that became effective against third parties as a result of the security right in the negotiable document becoming effective against third parties has priority over another security right in the goods that was made effective against third parties by a different method while the goods were covered by the document.

81. The law should provide that a security right in a negotiable document and the goods covered thereby is subject to the rights under the law governing negotiable documents of a person to whom the negotiable document has been duly negotiated.

Enforcement of a security right in a negotiable document

[*Note to the Commission: The Commission may wish to note that the commentary will also explain that the general recommendations on enforcement of security rights apply here as well, while recommendation 109 deals with a special issue.*]

109. The law should provide that after default, or before default with the agreement of the grantor, the secured creditor is entitled, subject to recommendation Z, to enforce a security right in negotiable document against the issuer or any other person obligated on the negotiable document.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that, under law governing negotiable documents, the issuer may be obligated to deliver the goods only to a holder of the negotiable document with respect to them.*]

Law applicable to security rights in tangibles

136. [*See recommendation 136 under III above.*]

[*Note to the Commission: The Commission may wish to note that a security right may be created in goods either pursuant to recommendation 8 or by the creation of a security right in a negotiable document representing those goods pursuant to recommendation 28 (see above). In either case, recommendation 136 provides that the creation, third-party effectiveness and priority of the security right are governed by the law of State of the location of the goods or document, as applicable. Because goods in transit and export goods, by their nature, move from State to State and, therefore, the location of the goods at any particular moment might be fortuitous and temporary, recommendation 142 provides an alternative method for creation and third-party effectiveness of a security right in such goods referring to the law of the State of the ultimate destination of the goods, provided that the goods reach that destination within a reasonable period of time. Recommendation 142 thus addresses the problems that could result from unwavering adherence to the "location of the tangible asset rule" in the context of goods whose location will certainly change as a result of the very nature of the financing transaction.*

The Commission may also wish to note, though, that, at its tenth session, the Working Group considered that, in many financing transactions involving negotiable documents it is also the nature of the transaction that the location of the negotiable document changes, as, for example, a bill of lading may move from the

consignor to the consignee to the secured creditor or other financier (see A/CN.9/603, para. 60). In addition, the Working Group noted that, in such transactions, at any particular time the negotiable document might be located in a different State than the goods that it represents, even though the goods and the negotiable document will ultimately be located in the same State. Accordingly, at that session, the suggestion was made that the practical issue with respect to the goods that is addressed by recommendation 142 might also be present for the negotiable documents representing those goods and that, accordingly, there may be some advantage in broadening the rule in recommendation 142 to cover negotiable documents. Thus, the Commission may wish to consider extending the application of recommendation 142 to negotiable documents. In that connection, the Commission may wish to take into consideration that, under recommendations 136 and 142, the priority of a security right in goods covered by a negotiable document is always subject to the law of the location of the document. If the applicable law is the law of a State that has enacted the recommendations of this Guide, under recommendation 80, the security right in the goods that became effective against third parties as a result of the security right in the negotiable document becoming effective against third parties will have priority over a security right in the goods that became effective against third parties by another method. The Commission may also wish to note that, under recommendation 148, the enforcement of the security right in the goods or the document is always subject to the law of the State where enforcement takes place or the law governing the security agreement (depending on which alternative is retained).]

Law applicable to third-party effectiveness of security rights in specified types of asset by registration

140. [*See recommendation 140 under III above.*]

Security rights in goods in transit and export goods

142. The law should provide that a security right in tangible property (other than negotiable instruments or negotiable documents) in transit or to be exported from the State in which it is located at the time of the creation of the security right may also be created and made effective against third parties under the law of the State of the ultimate destination, provided that the property reaches that State within a short time period of [to be specified] days after the time of creation of the security right.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that a security right in goods in transit and export goods can be created and made effective against third parties, under recommendation 136, in accordance with the law of the State of their location at the time of creation, or, under recommendation 142, in accordance with the law of the State of their ultimate destination. The commentary will also explain that the law of the State of the ultimate destination that governs creation and third-party effectiveness will apply even in the case of a contest with competing rights that were created and made effective against third parties while the export goods were located in the State of origin. In addition, the commentary will explain that the rule in this recommendation: (i) is applicable to encumbered assets that travel whether or not negotiable documents relating to the goods accompany the goods; (ii) is not applicable to encumbered goods that do not travel, whether or not negotiable*

documents relating to the goods do travel; and (iii) is not applicable to encumbered negotiable documents whether or not they travel.]

Law applicable to the rights and obligations of the grantor and the secured creditor

146. [*See A/CN.9/611.*]

Law applicable to the rights and obligations of the debtor of the receivable and the assignee, the obligor under a negotiable instrument or the issuer of a negotiable document and the secured creditor

147. [*See A/CN.9/611.*]

[*Note to the Commission: The Commission may wish to note that the commentary will explain that: (i) recommendation 148 applies to the enforcement of a security right in a negotiable document (A/CN.9/WG.VI/WP.24); and (ii) the recommendations on the impact of insolvency on the law applicable, as well as the other general recommendations in the conflict-of-laws chapter (A/CN.9/WG.VI/WP.24), apply to security rights in negotiable documents.*]

United Nations A/CN.9/611/Add.2

General Assembly

Distr.: General
17 May 2006

Original: English

United Nations Commission on International Trade Law
Thirty-ninth session
New York, 19 June-7 July 2006

Security Interests

Recommendations of the draft Legislative Guide on Secured Transactions

Note by the Secretariat*

Addendum

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* This document is submitted later than the required ten weeks prior to the start of the meeting because of the need to include changes decided at the tenth session of the Working Group held in New York from 1 to 5 May 2006.

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VII. Pre-default rights and obligations of the parties

Purpose

The purpose of the provisions of the law on pre-default rights and obligations of the parties is to enhance efficiency of secured transactions and reduce transaction costs and potential disputes by:

(a) Providing rules on additional terms for the security agreement;

(b) Eliminating the need to negotiate and draft terms to be included in the security agreement where the rules provide an acceptable basis for agreement;

(c) Providing a drafting aid or checklist of issues the parties may wish to address at the time of negotiation and conclusion of the security agreement; and

(d) Encouraging party autonomy.

Party autonomy

86. The law should provide that, except as otherwise provided in [specify the provisions that may not be derogated from or varied by agreement, e.g. standard of conduct in the context of enforcement], the secured creditor and the grantor may derogate from or vary by agreement its provisions relating to their respective rights and obligations. Such an agreement does not affect the rights of any person that is not a party to the agreement.

[*Note to the Commission: The Commission may wish to note that, at its tenth session, the Working Group agreed that recommendation 86 should be moved to the general part of the draft Guide (see A/CN.9/603, para. 90). As that part had already been issued before the tenth session of the Working Group, this decision will be implemented at the next version of the general part.*]

Additional terms for the security agreement

87. The law should include rules that provide, in particular, for:

(a) An obligation of the secured creditor or the grantor in possession of the encumbered assets to take any steps necessary to preserve, insure and pay taxes for the encumbered assets;

(b) A right of the secured creditor to make reasonable use of the encumbered assets in its possession or to inspect encumbered assets in the possession of the grantor;

(c) A right of the secured creditor to receive any proceeds derived from the encumbered assets in its possession or to have the security right extended in any proceeds of encumbered assets in the possession of the grantor;

(d) A right of the secured creditor to freely assign the secured obligation in which case the security right follows, unless otherwise provided by law;

(e) A right of the secured creditor to be reimbursed for reasonable expenses for the preservation of encumbered assets in its possession;

(f) An obligation of the grantor to make up for an unexpected devaluation of the encumbered assets;

(g) An obligation of the secured creditor to return the encumbered assets in its possession or terminate the notice registered upon full payment of the secured obligation and termination of all commitments to extent credit.

VIII. Default and enforcement

Purpose

The purpose of the provisions of the law on default and enforcement is to:

(a) Provide clear and simple procedures for the enforcement of security rights after debtor default in a predictable and efficient manner;

(b) Provide procedures that maximize the potential realization value of the encumbered assets for the benefit of the grantor, the debtor or any other person that owes payment of the secured obligation, the secured creditor and other creditors with a right in the encumbered assets;

(c) Provide for expeditious judicial and, subject to appropriate safeguards, non-judicial methods for the secured creditor to realize the value of the encumbered assets;

(d) Coordinate the secured transactions enforcement regime with other law governing the enforcement of claims in encumbered assets, including insolvency law.

Application of this chapter to outright transfers of receivables

88. [*See A/CN.9/611*]

General standard of conduct

89. The law should provide that all parties must exercise their rights and perform their obligations under the recommendations of this chapter in good faith and in a commercially reasonable manner.

Liability for failure to comply with recommendations of this chapter

90. The law should provide that any party that fails to comply with the obligations arising under the recommendations of this chapter is liable for any damages caused by that failure.

Limitations to party autonomy in the context of the enforcement of a security right

91. The law should provide that rights arising under recommendation 89 cannot be waived unilaterally or varied by agreement at any time. Subject to that exception: (i) the grantor and any other person that owes payment or other performance of the secured obligation may waive unilaterally or vary by agreement any of their rights and remedies under the recommendations of this chapter only after default, and (ii) the secured creditor may waive unilaterally or by agreement any of its rights and

remedies under the recommendations of this chapter at any time. A variation by agreement does not affect the rights of any person not a party to the agreement. A person challenging an agreement has the burden of showing that it was made prior to default or is inconsistent with recommendation 90.

[*Note to the Commission: The Commission may wish to consider whether a waiver or variation of the liability arising under recommendation 90 should be addressed in recommendation 91 or left to other law.*]

Rights and remedies after default

92. As more specifically provided in other recommendations of this chapter, the law should provide that after default the grantor and the secured creditor have the rights and remedies provided in the recommendations of this chapter, in the security agreement (except to the extent inconsistent with the mandatory recommendations of this chapter) and in any other law.

Secured creditor rights and remedies

93. As more specifically provided in other recommendations of this chapter, the law should provide that after default the secured creditor is entitled to:

(a) Obtain possession of a tangible encumbered asset;

(b) Collect on an encumbered asset that is a receivable, negotiable instrument, right to payment of funds credited to a bank account or proceeds under an independent undertaking;

(c) Enforce rights under a negotiable document;

(d) Sell or otherwise dispose of, lease or license an encumbered asset;

(e) Propose to the grantor that the secured creditor accept an encumbered asset in total or partial satisfaction of the secured obligation; and

(f) Exercise any other right or remedy provided in the security agreement (except to the extent inconsistent with the mandatory recommendations of this chapter) or any other law.

Judicial and extrajudicial enforcement

94. As more specifically provided in other recommendations of this chapter, the law should provide that after default the secured creditor is entitled to exercise the rights and remedies described in recommendation 93:

(a) By applying to a court or other authority; or

(b) Without applying to a court or other authority.

Grantor rights and remedies

95. As more specifically provided in other recommendations of this chapter, the law should provide that after default the grantor is entitled to:

(a) Pay in full the secured obligation after default and until the disposition, acceptance or collection of an encumbered asset by the secured creditor, and thereby obtain a release from the security right of all encumbered assets securing that

obligation, provided that all commitments of the secured creditor to extend credit have terminated;

(b) Apply to a court or other authority for relief if the secured creditor has not complied or is not complying with its obligations under the recommendations of this chapter with respect to extrajudicial enforcement;

(c) Reject the proposal of the secured creditor to accept an encumbered asset in total or partial satisfaction of the secured obligation within the time limits prescribed by the recommendations of this chapter; and

(d) Exercise any other right or remedy provided in the security agreement (except to the extent inconsistent with the mandatory recommendations of this chapter) or any other law.

Summary judicial proceedings

96. The law should provide for summary judicial proceedings with respect to the exercise of rights and remedies of the secured creditor, the grantor, and any other person who owes performance of the secured obligation or claims to have a right in the encumbered assets.

Cumulative rights and remedies

97. The law should provide that the exercise of a right or remedy does not prevent the exercise of another right or remedy.

Rights and remedies with respect to the secured obligation

98. The law should provide that the exercise of rights or remedies with respect to an encumbered asset under this law does not prevent the secured creditor from exercising its rights or remedies with respect to the obligation secured by that encumbered asset. The exercise of rights or remedies with respect to a secured obligation does not prevent the secured creditor from exercising its rights or remedies with respect to an encumbered asset that secures that obligation.

Release of the encumbered assets after full payment

99. The law should provide that, after default and until the disposition, acceptance or collection of an encumbered asset by the secured creditor, the debtor, the grantor or any other interested party (e.g. a secured creditor whose security right has lower priority than that of the enforcing secured creditor, a guarantor or a co-owner of the encumbered assets) is entitled to pay the secured obligation in full. If all commitments to extend credit have terminated, the effect of such payment is to release from the security right all encumbered assets securing that obligation or, to the extent provided in other law, to subrogate any other interested party that makes the payment to the rights of the secured creditor.

Relief with respect to extrajudicial enforcement

100. The law should provide that the debtor, the grantor or other interested parties (e.g. a secured creditor, a guarantor or a co-owner of the encumbered assets) are entitled to apply to a court or other authority for relief if the secured creditor has not complied or is not complying with its obligations under the recommendations of this

chapter. The law should build safeguards into the process to discourage unfounded applications and to prevent any improper interference with or undue delay of the secured creditor's ability to enforce its security right.

Secured creditor's right to possession of an encumbered asset

101. The law should provide that after default the secured creditor is entitled to possession of a tangible encumbered asset.

Alternative A

The secured creditor is entitled to take possession of the encumbered asset without applying to a court or other authority if: (i) it has given the grantor and any person in possession of the encumbered asset notice of default and (ii) possession can be taken without the use or threat of force.

Alternative B

The secured creditor is entitled to take possession of the encumbered asset without applying to a court or other authority, if: (i) it has given the grantor and any person in possession of the encumbered asset notice of default and of its intention to pursue extrajudicial enforcement and (ii) possession can be taken without the use or threat of force, or other similar illegal act.

Collection of receivables

102. [*For recommendations 102 and 103, see A/CN.9/611.*]

Negotiable instruments

104. [*For recommendations 104 and 105, see A/CN.9/611/Add.1.*]

Proceeds under an independent undertaking

106. [*See A/CN.9/611/Add.1.*]

Rights to payment of funds credited to a bank account

106 bis. [*For recommendations 106 bis, 107 and 108, see A/CN.9/611/Add.1.*]

Negotiable documents

109. [*See A/CN.9/611/Add.1.*]

Disposition of encumbered assets

110. As more specifically provided in other recommendations of this chapter, the law should provide that after default a secured creditor is entitled to sell or otherwise dispose of, lease or license an encumbered asset pursuant to recommendation 93 (d).

110 bis. The law should provide that a secured creditor that disposes of encumbered assets without applying to a court or other authority may select the method, manner, time, place, and other aspects of the disposition.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that this recommendation is subject to the standard of good faith and commercial reasonableness set out in recommendation 89. It will also explain that the purpose and effect of this recommendation is to provide a balance between the interests of both the grantor (and its other creditors) and the secured creditor in enabling flexibility in the methods used to dispose of the encumbered assets toward the end of obtaining an economically effective enforcement, while at the same time protecting the grantor against actions taken by the secured creditor that, in the commercial context, are not reasonable. The commentary will also explain that the secured creditor need not be in possession of the encumbered assets to exercise its rights and remedies under this chapter.*]

Advance notice with respect to extrajudicial disposition of encumbered assets

111. The law should require the secured creditor to give notice with respect to extrajudicial disposition of an encumbered asset after default. The law should:

(a) Specify that the notice should be given to: (i) the grantor, the debtor and any other person that owes payment of the secured obligation, (ii) any person with rights in the encumbered asset that, prior to the sending of the notice by the secured creditor to the grantor, has notified in writing the secured creditor of those rights, and (iii) any other secured creditor that, more than [...] days before the notice is sent to the grantor, has registered a notice of a security right in the encumbered asset under the name of the grantor or that was in possession of the encumbered asset at the time it was seized by the secured creditor;

(b) State the manner in which the notice is to be given, its timing, and its minimum contents, including whether the notice to the grantor should contain an accounting of the amount then owed and a reference to the right of the debtor or the grantor to obtain the release of the encumbered assets from the security right under recommendation 98;

(c) Provide that the notice should be in a language that is reasonably expected to inform its recipients about its contents (notice to the grantor is sufficient if it is in the language of the security agreement and, if the security right was made effective against third parties by registration, notice to all other persons is sufficient if it is in the language of the registry);

(d) Address the legal consequences of failure to comply with the recommendations governing the notice; and

(e) List circumstances in which the notice need not be given either because the time delay associated with requiring advance notice could have a negative effect on the realization value of the encumbered assets (as in the case of perishable tangibles or other assets whose value may decline speedily) or because the encumbered assets are of a sort sold on a recognized market (thereby obviating the need for advance notice).

112. The law should provide rules ensuring that the notice referred to in recommendation 111 can be given in an efficient, timely and reliable way so as to protect the grantor or other interested parties, while, at the same time, avoiding having a negative effect on the secured creditor's remedies and the potential realization value of the encumbered assets.

[Note to the Commission: The Commission may wish to note that the commentary will explain that these rules should balance the interest of the secured creditor in having the flexibility to dispose of the encumbered asset promptly in order to take advantage of favourable market conditions (an interest that also benefits the grantor and other interested parties) with the interest of the grantor and those other parties in obtaining notice of the disposition sufficiently before the disposition in order to take actions that might further protect their interests (such as locating potential buyers for the encumbered asset or attending a public disposition of the encumbered asset to verify the secured creditor's compliance with its obligations under this chapter. The commentary will also explain that the recommendation does not require registration of the notice because the notice meets the policy goals that could be served by registration. The Working Group may wish to define notice as written notice, except where otherwise provided in the law.]

Acceptance of encumbered assets in satisfaction of the secured obligation

113. The law should provide that after default a secured creditor may propose to accept, without applying to a court or other authority, one or more of the encumbered assets in total or partial satisfaction of the secured obligation.

114. The law should provide that a secured creditor that proposes to accept an encumbered asset in total or partial satisfaction of the secured obligation must send the proposal, specifying the amount owed as of the date the proposal is sent and the amount of the obligation that is proposed to be satisfied by accepting the encumbered asset to:

(a) The grantor, the debtor and any other person that owes payment of the secured obligation (e.g. a guarantor);

(b) Any person with rights in the encumbered asset that, more than [...] days prior to the sending of the proposal by the secured creditor to the grantor, has notified in writing the secured creditor of those rights; and

(c) Any other secured creditor that, more than [...] days before the proposal is sent to the grantor, has registered a notice of a security right in the encumbered asset in the name of the grantor or that was in possession of the encumbered asset at the time it was seized by the secured creditor.

115. The law should provide that, if a person to which a proposal to accept an encumbered asset in total or partial satisfaction of the secured obligation must be sent under recommendation 114 objects in writing to such a proposal within [a short time, such as 20 days] after the proposal is sent, the secured creditor may not proceed with the proposal.

Distribution of proceeds of enforcement

116. The law should provide that, in the case of extrajudicial enforcement, the enforcing secured creditor must apply the net proceeds of its enforcement (after deducting costs of enforcement) to the secured obligations. Except as provided in recommendation 117, the enforcing secured creditor must pay any surplus remaining after such application to subordinate competing claimants, that, prior to any distribution of the surplus, gave written notice of their claims to any surplus to

the enforcing secured creditor. Any balance remaining must be remitted to the grantor.

117. The law should also provide that, in the case of extrajudicial enforcement, whether or not there is any dispute as to the entitlement of any competing claimant or as to the priority of payment, the enforcing secured creditor may, in accordance with generally applicable procedural rules, pay the surplus to a competent judicial or other authority or to a public deposit fund for distribution. In the case of such payment, the surplus should be applied in accordance with the priority rules of this law.

118. The law should provide that distribution of the proceeds realized by a judicial disposition or other officially administered process is to be made in accordance with general rules of the State governing execution proceedings, but in accordance with the priority rules of this law.

119. The law should provide that the debtor and any other person that owes payment of the secured obligation are liable for any shortfall still owing after application of the net proceeds of enforcement to the secured obligation.

Right of prior-ranking secured creditor to take over enforcement

120. The law should provide that, at any time before final disposition, acceptance or collection of an encumbered asset, a secured creditor whose security right has priority over that of the enforcing secured creditor or judgement creditor is entitled to take control of the enforcement process. The right to take control includes the right to continue enforcement, enforce by a different method provided in the recommendations of this chapter, and choose whether or not any remedy under the recommendations of this chapter will be administered by a court or other authority.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that the secured creditor with priority has the right to substitute its own enforcement process under this law for judgement enforcement proceedings initiated by a subordinate judgement creditor under other law but does not have the right to continue the enforcement process initiated by the judgement creditor under that other law.*]

Title or other right acquired through non-judicial disposition

121. The law should provide that, if a secured creditor disposes of an encumbered asset without applying to a court or other authority, the person that acquires the asset in good faith pursuant to the disposition (i) acquires the grantor's right in the asset subject to rights that had priority over the security right of the enforcing secured creditor and (ii) takes free of the rights of, the enforcing secured creditor and any competing claimant whose right has a lower priority than that of the enforcing secured creditor. The same rule applies to an encumbered asset acquired by a secured creditor that has accepted the encumbered asset in total or partial satisfaction of the secured obligation.

122. The law should provide that, if a secured creditor disposes of a partial right in an encumbered asset or leases or licenses an encumbered asset without applying to a court or other authority, the person that acquires the partial right, lease or licence in good faith pursuant to the disposition, lease or licence (i) acquires the grantor's

right in the asset to the extent of the disposition, lease or licence subject to rights that had priority over the security right of the enforcing secured creditor and (ii) takes free of the rights of the enforcing secured creditor and any competing claimant whose right has a lower priority than that of the enforcing secured creditor.

Title or other right acquired through judicial disposition

123. The law should provide that, if a secured creditor disposes of an encumbered asset through a judicial or other officially administered process, the title or other right acquired by the transferee is determined by the general rules of the State governing execution proceedings.

Intersection of movable and immovable property enforcement regimes

124. The law should provide that:

(a) A security right in attachments to immovable property may be enforced in accordance with either this law or the law governing enforcement of encumbrances on immovable property; and

(b) If an obligation to a secured creditor is secured by both a security right in an encumbered asset of the grantor and by an encumbrance on an immovable property of the grantor, the secured creditor may enforce: (i) both the security right and the encumbrance under the law governing enforcement of encumbrances on immovable property or (ii) the security right under this law and the encumbrance under the law governing enforcement of encumbrances on immovable property.

[*Note to the Commission: The Commission may wish to note that the law should be coordinated with general civil procedure law to provide a right for secured creditors to intervene in court proceedings initiated by other creditors of the grantor so as to protect security rights and to ensure the same priority status of security rights as under the law.*]

United Nations A/CN.9/611/Add.3

General Assembly

Distr.: General
22 May 2006

Original: English

United Nations Commission on International Trade Law
Thirty-ninth session
New York, 19 June-7 July 2006

Security Interests

Draft Legislative Guide on Secured Transactions

Note by the Secretariat*

1. At its current session, the Commission is expected to consider and approve in principle the substance (i.e. the policy rather than the formulation) of the recommendations of the draft UNCITRAL Legislative Guide on Secured Transactions ("the draft Guide").

2. The recommendations and the commentaries thereto are contained in various documents. In order to assist the Commission in identifying the document in which each chapter is contained, the Secretariat has included in an annex to this note a list of the chapters of the draft Guide indicating in which document the recommendations and the commentary relating to each chapter may be found.

* This document is submitted later than the required ten weeks prior to the start of the meeting because of the need to include the documents submitted after the tenth session of the Working Group held in New York from 1 to 5 May 2006.

V.06-54235 (E) 290506 290506

Annex

I. Recommendations**

Chapter I. Key objectives	A/CN.9/WG.VI/WP.26/Add.7
Chapter II. Scope of application	A/CN.9/WG.VI/WP.26/Add.7
Chapter III. Basic approaches to security	A/CN.9/WG.VI/WP.26/Add.7
Chapter IV. Creation of the security right (effectiveness as between the parties)	A/CN.9/WG.VI/WP.26/Add.7
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Security rights in negotiable instruments	A/CN.9/611/Add.1
Security rights in negotiable documents	A/CN.9/611/Add.1

** The numbering of the chapters may not correspond to the numbering on the documents above, as chapters were merged or moved at different points of time. The titles, however, of the chapters remain essentially the same.

II. Commentaries***

Background remarks	A/CN.9/WG.VI/WP.27
Chapter I. Introduction	A/CN.9/WG.VI/WP.27/Add.1
Chapter II. Key objectives	A/CN.9/WG.VI/WP.27/Add.1
Chapter III. Basic approaches to security	A/CN.9/WG.VI/WP.9/Add.1
Chapter IV. Creation	A/CN.9/WG.VI/WP.11/Add.2
Chapter V. Effectiveness against third parties	A/CN.9/WG.VI/WP.14
Chapter VI. Priority	A/CN.9/WG.VI/WP.14/Add.1
Chapter VII. Pre-default rights and obligations of the parties	A/CN.9/WG.VI/WP.9/Add.4
Chapter VIII. Default and enforcement	A/CN.9/WG.VI/WP.27/Add.2
Chapter IX. Insolvency	A/CN.9/WG.VI/WP.9/Add.6
Chapter X. Acquisition financing devices	A/CN.9/WG.VI/WP.17 and Add.1
Chapter XI. Conflict of laws	A/CN.9/WG.VI/WP.19
Chapter XII. Transition issues	A/CN.9/WG.VI/WP.26/Add.8
Security rights in proceeds, attachments, masses of goods and products	commentaries in the relevant chapters
Security rights in receivables	not issued yet
Security rights in rights to payment of funds credited to a bank account	A/CN.9/WG.VI/WP.18 and Add.1
Security rights in proceeds under an independent undertaking	not issued yet
Security rights in negotiable instruments	not issued yet
Security rights in negotiable documents	not issued yet

*** With the exception of A/CN.9/WG.VI/WP.27 and Addenda 1 and 2, which have already been updated, the commentaries need to be updated.

United Nations A/CN.9/612

General Assembly

Distr.: General
22 May 2006

Original: English

United Nations Commission on International Trade Law
Thirty-ninth session
New York, 19 June-7 July 2006

Transport Law: Preparation of a draft convention on the carriage of goods [wholly or partly] [by sea]

Joint proposal by Australia and France on freedom of contract under volume contracts

Note by the Secretariat*

In preparation for the thirty-ninth session of the Commission, the delegations of Australia and France submitted to the Secretariat the document attached hereto as an annex containing a joint proposal on freedom of contract under volume contracts in the draft convention on the carriage of goods [wholly or partly] [by sea] being considered in Working Group III (Transport Law). The text is reproduced as an annex to this note in the form in which it was received by the Secretariat.

* The late submission of the document reflects the date on which the document was submitted to the Secretariat.

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Annex

Introduction

1. The draft version of article 95 on special rules for volume contracts was examined at the seventeenth session of Working Group III. Few changes were made during that session to the version of the article proposed to the Working Group. Several delegations nevertheless voiced concerns about the extent of freedom of contract allowed under volume contracts. The European Shippers Council, commenting for the first time at the Working Group, also pointed to difficulties that the current version of the draft text could raise.

2. It should also be stressed that the draft instrument initially submitted to the Working Group did not contain any general provisions favourable to freedom of contract.[1] The draft version of article 95 reflected a clear change in the direction of the Working Group's work, because it was only introduced during the fifteenth session of the Working Group, when the instrument had already been substantially drafted.

3. Australia and France therefore consider that further debate is required on this important issue. They would like to draw the Commission's attention in a plenary session to the issue of freedom of contract in the draft instrument and submit alternative proposals.

Historical context

4. The history of the law of carriage of goods by sea is the history of the gradual introduction of mandatory rules on liability. By the late nineteenth century, freedom of contract was being used extensively and aggressively by ship-owners to unfairly reduce their liabilities for cargo loss or damage. To combat such practice, in 1893 the United States introduced the Harter Act, a mandatory regime governing trade with the country. This was followed in 1924 with the signing of the International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, which now forms the foundation of the law on carriage of goods by sea. That Convention states that "any clause, covenant, or agreement in a contract of carriage relieving the carrier or the ship from liability for loss or damage to, or in connexion with, goods arising from negligence, fault, or failure in the duties and obligations provided in this Article or lessening such liability [...], shall be null and void and of no effect".

5. This mandatory regime of liability is found today, in highly comparable terms, in the international conventions on the different modes of carriage.[2] Consequently, as it stands, the instrument currently being drafted is the only one to contain provisions that offer considerable scope to freedom of contract.

6. The shift, through the mechanism of volume contracts, from a fundamentally mandatory regime to a largely derogative regime represents a major change. The risk is that in some States obstacles may arise to ratification of a convention whose provisions, which differ sharply from national legislation in the field, appear to be incompatible with fundamental principles of domestic law.

Analysis of the current provisions on freedom of contract

7. The definition of a volume contract given in article 1 of the draft instrument could cover a wide range of contracts of carriage. Indeed, the new version adopted on a proposal from the Finnish delegation, clearly states that "a volume contract is a contract of carriage".[3] This definition of a volume contract is distinguished by its lack of limitation, whether in terms of the duration of the two parties' commitment, the number of shipments or the quantities carried. A volume contract could therefore potentially cover almost all carriage of goods by shipping lines falling within the scope of the convention. This is likely to leave a loophole in the convention that would enable the parties to release themselves from the binding provisions of the instrument. For example, it is quite conceivable, from a legal point of view, that the carriage of two containers over a period of one year could be governed by a volume contract.

8. With respect to the "special rules for volume contracts" set forth in article 95, which are designed to introduce freedom of contract into this framework, the conditions established for the article's application appear equally devoid of limitation.

9. First, regarding the conditions of form for derogations from the convention, it is only stipulated that the volume contract "is individually negotiated *or* prominently specifies the sections [...] that contain derogations" (art. 95.1 (a) and (b))". More precisely, the conditions indicated do not require that both parties to the contract expressly consent to the derogations: this clearly opens up the possibility that *standard contracts* containing derogating clauses could be submitted to the shippers. The principle of freedom of contract should, however, be based on genuine negotiation between the shipper and the carrier. If volume contracts are to be the basis of wide-ranging derogations from the terms of the draft conventions, it is imperative that those volume contracts be genuinely negotiated between the parties.

10. Secondly, regarding the scope of the authorized derogations, the limits set on the carrier's right to derogate from the Convention seem extremely weak. It appears paradoxical that the right to derogate from the Convention is established as a principle (art. 95.1).[4] The only exclusions from this right, set forth in paragraph 4, are the carrier's obligation to keep the ship seaworthy and properly man the ship (art. 16.1), and the loss of the right to limit liability (art. 66). Furthermore, these limits do not appear to have been set in the interests of the shipper, but to have been designed as minimal obligations with respect to public interest, given the risks associated with an unseaworthy vessel in particular.

11. Australia and France contend that the public interest defended by other provisions of the convention comprises a minimal level of protection for the contracting parties and that the draft texts on freedom of contract should be revised accordingly.

Proposals regarding volume contracts

12. It would be preferable to clarify the definition of "volume contract" given in draft article 1 (b) as follows (the proposed amendments appear in bold type):

"'Volume contract' means a contract that provides for the carriage of a **set** quantity of cargo in a series of shipments during a **set** period of time **of no less than one year**. The **set** quantity may be a minimum, a maximum or a certain range."

13. It would be desirable for the derogations from the provisions of the instrument to be subject to express agreement by the two parties. In article 95.1 (a) we propose making the conditions of form cumulative by replacing "or" by "and" and, in (b), "clear" by "in highly visible type". This will provide a much stronger safeguard against misuse of the right of derogation than merely allowing a situation in which a standard form contract with a derogation noted in the text can be used to satisfy the requirements of 95.1 (as could be the case with the draft of art. 95 contained in both A/CN.9/WG.III/WP.56 and A/CN.9/WG.III/WP.61).

14. We propose not allowing any derogation from the liability regime set in the Convention, which is the core of the draft instrument, or from the fundamental obligations of the carrier and the shipper.

Thus, Australia and France suggest that paragraph 4 of article 95 could read as follows:

"Paragraph 1 does not apply to:

"(a) article 17 (basis of the carrier's liability), or to article 66 (right to limit liability);

"(b) article 31 (basis of the shipper's liability);

"(c) chapter 5 (obligations of the carrier); or

"(d) articles 28 to 30, and 33 (obligations of the shipper)."

15. Alternatively, a more concise version of the entire article 95 could read as follows:

"1. The parties to a volume contract may derogate from the provisions of this convention only if :

"(a) the volume contract is individually negotiated;

"(b) the derogation is agreed in writing between the parties; and

"(c) the derogation is set forth in highly visible type in the volume contract in a manner that identifies the clauses of the volume contract containing derogations.

"2. Any such derogation is not binding on third parties, unless those third parties accept it expressly.

"3. Any derogation made pursuant to paragraph 1 does not apply to the basis of the liability of the carrier or the shipper, as set forth in articles 17 and 31 respectively, nor to the fundamental obligations of the carrier or the shipper, as set forth in chapter 5 and in articles 28 to 30, and 33 respectively, and any derogation is null and void to the extent that it purports to so apply."

Notes

[1] Document A/CN.9/WG.III/WP.32, the initial version of the draft convention, clearly stated that "any contractual stipulation that derogates from this instrument is null and void, if and to the extent it is intended or has to its effect, directly or indirectly, to exclude, [or] limit [, or increase] the liability for breach of any obligation of the carrier, a performing party, the shipper, the controlling party, or the consignee [...]."

[2] The Convention on the Contract for the International Carriage of Goods by Road (CMR) stipulates that: "any stipulation which would directly or indirectly derogate from the provisions of this Convention shall be null and void" (Art. 41.1). Similarly, the Montreal Convention of 1999 on air carrier liability, states that "any provision tending to relieve the carrier of liability or to fix a lower limit than that which is laid down in this Convention shall be null and void" (Art. 26). On the carriage of goods by inland waterways, the Budapest Convention of 2001 (which came into force in 2005) also states that "any contractual stipulation intended to exclude, limit or increase the liability, within the meaning of this Convention, of the carrier, the actual carrier or their servants or agents, shift the burden of proof or reduce the periods for claims or limitations [...] shall be null and void. Any stipulation assigning a benefit of insurance of the goods in favour of the carrier is also null and void."

[3] The draft version of article 1 (b) sets forth: "'Volume contract' means a contract that provides for the carriage of a specified quantity of cargos in a series of shipments during an agreed period of time. The specification of the quantity may include a minimum, a maximum or a certain range."

[4] The draft version of article 95.1 states: "[...] the volume contract may provide for greater or lesser duties, rights and obligations and liabilities than those set forth in the Convention [...]."